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July 9, 2003

Mr. Charles Evans  
Office of Long Island Sound Program  
Department of Environmental Protection  
79 Elm Street  
Hartford, CT 06106

Dear Mr. Evans:

I have been informed that the Office of Long Island Sound Programs ("OLISP") is reviewing the application of Islander East Pipeline Company, LLC ("Islander East") for a certificate of consistency with the Council Zone Management Act ("CZMA"). I understand that this evaluation is prompted by a review from the United States Department of Commerce ("Commerce"). Specifically, Islander East filed a CZMA application which was denied on October 15, 2002, which denial was subsequently appealed, pursuant to federal law, to the Department of Commerce. During the pendency of this appeal, a sufficient number of amendments were made to the original plan that a remand was necessary to permit OLISP to reconsider the matter.

I am writing to offer my comments on the Islander East proposal relative to the CZMA process and provide OLISP with information that may be helpful in its administrative review.

**Background**

**1. The Project.**

As you are aware, Islander East proposes to build a 50-mile long interstate natural gas pipeline creating an additional link between the Connecticut and Long Island markets. Approximately 19 miles of the pipeline would be constructed under the Long Island Sound.

As described in the company's literature, the purpose of the project is to provide 285,000 dekatherms per day (Dth/d) of natural gas to Long Island, enough to heat about 600,000 homes. This description of the project's purpose is repeated in the Environmental Impact Statement, released August, 2002, ("EIS"), prepared by the staff of the Federal Energy Regulatory Commission ("FERC") as mandated by the National Environmental Policy Act, 42 U.S.C. § 4321, *et seq.* ("NEPA").

## **2. Coastal Zone Impacts.**

As described in the EIS, the project will involve both onshore and offshore impacts in and around the Long Island Sound. In this regard, it is difficult to overstate the importance, environmentally, esthetically, and economically, of the Sound. More than a decade ago, an independent analysis prepared for the United States Environmental Protection Agency concluded that annual shellfishing and finfishing resources could be valued at approximately \$148,000,000. Recreational use was valued in excess of \$300,000,000 and the total of all direct and indirect economic use of the Sound produced a "total use value" of more than \$5,200,000,000. Coastal wetlands associated with the Sound added another \$90-100,000,000. And all of this, it must be stressed, was calculated in 1990 dollars. Staggering as these numbers are, they do not begin to tell the full story.

Prior to European colonization, the Sound supported a vast and interconnected ecosystem of immense productivity. Even after centuries of human impact, industrial pollution and overfishing, the Sound remains, "an 'essential fish habitat' (EFH), defined as being necessary for fish spawning, breeding, feeding, or growth to maturity, for a variety of fish species." Connecticut Siting Council Findings of Fact, Dckt. No. 197, TransEnergie Application for Certificate of Environmental Compatibility and Public Need, March 28, 2001, para. 86. In fact, "Long Island Sound is an environment used by Kemps ridley, Loggerhead, Green, and Leatherback marine turtles [which species] are listed as State or Federal Endangered or Threatened Species, according to Connecticut DEP and NOAA National Marine Fisheries Service." *Id.*, para. 83. Consequently, it is no exaggeration to say that protecting the last vestiges of a heavily impacted but still critically important natural resource is an important national interest.

While the entire Sound is important, there appear to be within it areas that have suffered less from development and industrial activity or otherwise have especially important resources. As noted in recent testimony before the Connecticut Siting Council regarding the Islander East project, the specific area that will be affected along the Connecticut coast, sometimes referred to as the Thimble Islands area, is both unusually important and vulnerable. "This particular area has been, -- first of all from a historical standpoint, the Thimble Island area has been essential for an oystery fishery for over a hundred years. That's fairly well documented. There are a great many oyster beds in the immediate area that have been very important to the shellfish industry for quite some time as I said. Some of the ground is both used also for clams and oysters. Sometimes you can get two crops on one piece of ground." (Testimony of L. Williams, April 17, 2002, p.85).

The project envisioned by Islander East is monumental both in scope and effect. As one expert testified, the Islander East project will be "one of the major most impactful environmental

effects on Long Island Sound, the New York side as well as Connecticut, that I've ever seen." (Testimony of Dr. L. Stewart before the Connecticut Siting Council, April 12, 2002, p. 194.)

Offshore, the project proposes use of horizontal directional drilling ("HDD") to bring the pipe from landfall to a point (the "punchout" point) approximately 3500 feet from shore. (EIS, pp. 3-37, 3-62 to 3-63.) From there, Islander East plans to construct, by clamshell dredge, a transition pit or trench from where the HDD will exit for a distance of about 1 to 2 miles. (*Id.*) From that point to the New York landfall, a plow will be used to bury the pipe. As planned, the project would include in excess of 22 miles of pipeline under the Long Island Sound. Onshore, the route chosen by the company would require clearing woodlands owned and managed by the Branford Land Trust, filling and trenching in many acres of wetlands, and extensive excavations in various residential neighborhoods. (See, EIS, pp. 3-98, 3-131.)

The EIS identifies a number of serious environmental impacts. Approximately 30 acres of wetlands would be disturbed by the construction itself and these acres would be subject to continual disruption due to periodic maintenance operations along the pipeline. (EIS, p. 3-98.) Not only would this construction result in serious damage to coastal wetlands directly tied into the greater Connecticut coastline ecosystem, but the project's ongoing maintenance activities would result in *permanent* changes to a number of important and environmentally-sensitive areas. (See, EIS p. 3-80.)

Offshore, impacts may be even more severe. Specifically, the company plans to connect the land-based portion of the project to the main deep-water pipeline trench by using horizontal directional drilling ("HDD") to bore under the beach for about 3500 feet into deeper water. (EIS, pp. 3-37, 3-62 to 3-63.) The HDD would, however, erupt in the middle of the valuable shellfish habitat between Branford Harbor and the Thimble Islands, in an area that has been spared development over the years and is so pristine that it has been referred to as a perfect location for a marine sanctuary. (Testimony of Dr. L. Stewart before the Connecticut Siting Council, April 12, 2002, p. 254.) As Dr. Stewart stated, the HDD would release huge quantities of bentonite drilling mud "smack dab in the middle of one of the most highly valuable, multiple marine ecological environments there is on the coast of Connecticut." (*Id.* at 236.) Even the company's own expert said of the Thimble Islands area that "the resources include both the commercial fishery and the recreational aspects of the area, the view vista, and the diversity of the habitat, it's a very sensitive area. . . ." (Testimony of Dr. Bohlen before the Connecticut Siting Council, April 16, 2002, p. 34.)

It is in this "very sensitive area" that Islander East plans to dig the HDD punchout hole and accompanying dredged pit. (EIS, p. 3-62.) The company's activities in this regard, involving only the HDD drilling phase, will result in releasing "approximately 448,300 barrels" of bentonite drilling fluid into the environment and excavating a bowl-shaped undersea pit approximately 250 by 300 feet in size to a depth of 20 feet. (EIS, p. 3-53.) This phase alone will

impact 23 acres of prime shellfish habitat, all in an area of unsurpassed natural diversity and beauty. (See, EIS, p. 3-45, table 3.3.3-1.)

The impacts to coastal resources, however, are not limited to the initial phase of this project. From the HDD outfall point, the pipe is to be laid in a trench for part of the way across the Sound and then buried by jet plow for the remainder of the distance to Long Island. The EIS, and the Findings of Fact of the Connecticut Siting Council, clearly show the extent to which this effort will impact marine resources. It is estimated that 3000 acres of underwater habitat will be disturbed. (EIS, p. 3-45.) The amount of sediment that this project will disturb is staggering -- dredging phase, 44,700 cubic yards, and plowing, up to 504,400 cubic yards. (EIS, p. 3-44.) In addition to these impacts, Islander East predicts that the dragging and other movement of the cables anchoring the work barges (an effect known as 'cable sweep') would damage an area far from the actual trench cuts and up to 2500 feet from the barges. (EIS, p. 3-71.) Further, Islander East estimates that the repeated barge re-positionings will result in up to 120 anchor holes per mile of pipeline trench. (EIS, p. 3-71.) Anchor holes are relatively deep in terms of topography of the seafloor and create oxygen-deprived sediment traps that persist for many years and have a serious adverse impact on shellfishing operations. As the EIS concludes, all of this may "represent a long-term conversion of shellfish habitat [into habitat which will not support shellfish]." (EIS, p. 3-71.)

In addition to the direct impacts just described, the EIS clearly shows that there would be important indirect impacts as well. For example, "the water and sediment quality of many coastal waters in the area are impacted by proximity to urban centers and by industrial and agricultural activities. Pollutants enter in the form of sewage effluent, industrial discharge, dredge spoils, urban runoff, riverine discharge, and atmospheric deposition". (EIS, p. 3-42.) Not surprisingly, therefore, when Islander East took sediment samples (a total of only 23 for about 20 miles of seafloor), they discovered toxic metals in some of the samples at levels indicating contamination. (EIS, p. 3-43.) Of course, disturbance of hundreds of thousands of cubic yards of contaminated sediments will re-mobilize the pollutants, resulting in additional adverse effects on coastal resources, which impacts cannot even be analyzed because a proper data set has not yet been prepared. (See, Letter of the EPA to the FERC, dated Sept. 30, 2002.)

The impacts described above are particularly acute because past experience in the Sound has demonstrated that the effects of underwater construction operations *persist for decades* and effectively eliminate any possibility of commercial shell fishing operations into the foreseeable future. (Testimony of Dr. L. Stewart before the Connecticut Siting Council, April 12, 2002, p. 192; EIS, p. 3-70.) Overall impacts to the Sound, therefore, include excavation of hundreds of thousands of cubic yards of sediment, some of which has been contaminated by various toxic substances, destruction of hundreds of acres of shellfish habitat and degradation of water quality, primarily by sedimentation.



In this regard, it is informative to note the comments of Mr. John Volk, the former Director of the Connecticut Bureau of Aquaculture, on this project in a letter to the ACOE. He states, after noting the variety and wealth of shellfish and other natural resources in the affected area, that:

The use of a plow or jet sled for pipe burial through a sea floor corridor of approximately 23 miles, will result in impacts due to suspended sediment, alteration and/or destabilization of the sea floor, and damage or death to marine life.

An additional concern regarding this project and other proposed submarine utility projects, is the potential cumulative impacts to Long Island Sound's habitat, water quality and fisheries. . . . Alternatives and options regarding energy sources, siting and construction methods should be fully assessed on a regional basis by the regulatory community.

Consequently, Director Volk concluded:

We have determined that the siting and the construction methods for the marine phase of the project will likely cause significant damage and harm to shellfish resources and shellfish habitat. Shellfish aquaculture, commercial and recreational shellfish harvest operations, are likely to be impacted as well. This determination is based on the review of the information provided in the above referenced documents, consultations, as well as staff field experience with a similar project. We therefore recommend that the marine portion of the current application be denied.

## **II. Relevant State Law.**

The Connecticut legislature has established a set of guiding principles for evaluating coastal impacts.

The General Assembly finds that the growing population and expanding economy of the state have had a profound impact on the life-sustaining environment. The air, water, land and other natural resources, taken for granted since the settlement of the state, are now recognized as finite and precious. . . . Therefore the General Assembly hereby declares that the policy of the state of Connecticut is to conserve, improve and protect its natural



resources and environment and to control air, land and water pollution in order to enhance the health, safety and welfare of the people of the state. It shall further be the policy of the state to improve and coordinate environmental plans, functions, powers and programs of the state . . . and to manage the basic resources of air, land and water to the end that the state may fulfill its responsibility as trustee of the environment for the present and future generations.

Conn. Gen. Stat. § 22a-1.

The legislature has gone further, expressly defining the policy of the state with respect to the Long Island Sound. In doing so it made numerous legislative findings, including the following:

- (1) The waters of Long Island Sound and its coastal resources . . . form an integrated natural estuarine ecosystem which is both unique and fragile;
- (2) Development of Connecticut's coastal area has been extensive and has had a significant impact of the Long Island Sound and its coastal resources; . . .
- (5) The coastal area is rich in a variety of natural, economic, recreational, cultural and aesthetic resources, but the full realization of their value can be achieved only by encouraging further development only in suitable areas and by protection of those areas unsuited to development;
- (6) The key to improved public management of Connecticut's coastal area is coordination at all levels of government and consideration by municipalities of the impact of development on both coastal resources and future water-dependent development opportunities when preparing plans and regulations and reviewing municipal and private development proposals; and
- (7) Unplanned population growth and economic development in the coastal area have caused the loss of living marine resources, wildlife and nutrient-rich areas, and have endangered other vital ecological systems and scarce resources.

Conn. Gen. Stat. § 22a-91.

Based upon its findings as described above, the legislature has established a set of goals and policies to govern the management of resources in and around the Long Island Sound as follows:

- (2) To preserve and enhance coastal resources in accordance with the policies established by chapters 439, 440, 446i, 447, 474 and 477;
- (3) To give high priority and preference to uses and facilities which are dependent upon proximity to the water or the shore lands immediately adjacent to marine and tidal waters;
- (4) to resolve conflicts between competing uses on the shore lands adjacent to marine and tidal waters by giving preference to uses that minimize adverse impacts on natural coastal resources while providing long term and stable economic benefits;
- ...
- (9) To coordinate planning and regulatory activities of public agencies at all levels of government to insure maximum protection of coastal resources . . . ; and
- (10) To insure that the state and coastal municipalities provide adequate planning for facilities and resources which are in the national interest as defined in section 22a-93 and to insure that any restrictions or exclusions of such facilities or uses are reasonable. Reasonable grounds for the restriction or exclusion of a facility or use in the national interest shall include a finding that such a facility or use: (A) May reasonably be sited outside a coastal boundary . . . .

Conn. Gen. Stat. § 22a-92.

State law, therefore, provides several principles that are important in evaluating the Islander East proposal. These include a mandatory preference for water dependent uses if conflicts occur with economic development projects, a clear emphasis on protection of threatened resources, and a statutory right of denial of projects that may reasonably be sited elsewhere. Consequently, it is critical to examine the Islander East project with a view to its demonstrable impacts, the nature and quality of the resources threatened, and whether the project purpose can be successfully accomplished by a less environmentally damaging alternative. To accomplish this, it is necessary to examine initially the defined project purpose.



**Purpose.**

As noted above, “[t]he purpose of the Islander East Pipeline Project is to provide transportation service for 285,000 dekatherms of natural gas from supply areas, including eastern Canada, to energy markets in Connecticut and New York (specifically Long Island and New York City).” (EIS, p.2) By its terms, therefore, the point of the project is to get natural gas to Long Island.

There are, however, two major issues regarding the defined project purpose. The first is that the officially defined purpose does not survive close scrutiny. The second, and more important issue, is that absolutely nothing in the defined project purpose necessitates use of any particular pipeline route and pursuant to Conn. Gen. Stat. §§ 22a-92, 93(17), 105, 106, and 108, it is a violation of the CZMA to locate non-water dependent activities with significant impacts in sites physically suited for water-dependent uses, particularly when alternatives are available. See also, Section 404(b)(1) of the federal Clean Water Act, 33 U.S.C. § 1251, *et seq.*

With regard to the first issue, the market need identified by Islander East is suspect at best. It appears that the market analysis data upon which Islander East predicated its statement of natural gas demand on Long Island predate the events of September 11, 2001 and the ongoing economic slowdown.

As the attached report (Exhibit A) shows, the “need” for this project was based on what are termed “precedent agreements” entered into with the developers of proposed electric power generation stations on Long Island. However, these developers have either ceased project development or have made alternative arrangements for fuel supply. (Ex. A, p. 2.) Ultimately, Islander East has “substantially overstate[d]” the anticipated growth of the natural gas market on Long Island and has failed to properly consider the additional pipeline infrastructure programs currently proposed or under construction. *Id.* The result is that, while Islander East continues to announce its project purpose as providing 285,000 Dth/day to Long Island, the supposed project need has no justification and is, in fact, chimerical.

Further, it is clear that current information suggests that the Islander East project could well have a detrimental effect on economic activity. Specifically, independent regional regulators have already described the natural gas supply situation in New England as “tight-as-drum” and noted that inducing “additional demand stress . . . competing for the existing delivery capacity of New England’s pipelines has potentially ominous strategic implications for the security of New England’s power supply.” (Steady-State Analysis of New England’s Interstate Pipeline Delivery Capacity 2001-2005, produced for ISO-New England, Inc.) (Emphasis in original.) More recently, Alan Greenspan has stated in a published news report (Ex. B) that supplies of natural gas are expected to be limited for a prolonged period. If true, this means an increase in prices, which would substantially depress the potential market on Long Island. As

the attached report states: "growth in gas demand is sensitive to changes in the price of gas. High and volatile gas prices typically inhibit demand growth." (Ex . A, p 8.) Consequently, Islander East has built its project on a false statement of need.

This leads to a second, but related, issue. Even if Islander East's unsupported assumptions are accepted, purely for argument's sake, the proposed purpose can be satisfied by any of a variety of alternatives. Simply put, if the goal is to transport more natural gas to Long Island, there is no reason that the pipeline needs to be placed in the Thimble Islands reach of the Sound.

For example, the FERC staff concluded its independent project review and stated:

We evaluated six system alternatives, one of which, the ELI System Alternative, is based on Iroquois' ELI Extension Project. The second is based on Tennessee's planned Connecticut-Long Island Lateral Project. The third is based on other existing or planned systems in New York or New Jersey and the fourth is based on the local distribution company's (KeySpan) existing facilities. We also considered two other system alternatives (the One-Pipe System Alternative and the Long Island System Alternative) both of which would carry the total volumes of the ELI Extension Project and the Islander East Project.

We have determined that one of these system alternatives, the ELI System Alternative, is environmentally preferable because it has a shorter Long Island Sound crossing, avoids more shellfish leases, and would only have air quality and noise impacts onshore in Connecticut. The impacts on Long Island would be identical to the Islander East Project.

Our analysis of the system alternative offshore pipeline indicates the crossing of the Sound would be reduced by 5.5 miles. The ELI System Alternative would open-cut about 936 feet of shellfish leases, avoiding direct impacts to other near shore leases by tapping into Iroquois' existing pipeline offshore. Islander East would open-cut about 6,141 feet of shellfish leases, avoiding direct impact to other leases by drilling the Connecticut shoreline. Construction offshore would impact 2,930 acres for the ELI System Alternative and 3,106 acres for the proposed project. For a more complete discussion of the offshore impacts of the ELI

System Alternative see the discussion of Iroquois' offshore pipeline in the Environmental Report for the Eastern Long Island Extension Project filed in Docket No. CP02-52-000.

Based on our environmental analysis, the ELI System Alternative is environmentally preferable to the proposed route because it reduces onshore and offshore impacts, except for emissions.

The conclusion reached by the staff of the FERC has been echoed by essentially every independent regulator which has reviewed this project. For example, the United States Environmental Protection Agency ("EPA") has stated:

ELI system alternative. This alternative would be shorter in length in the Connecticut onshore portion, as well as the Long Island Sound offshore portion, although there would be differences in terrain traversed (no detail provided). It would cross fewer streams and would apparently avoid shellfish beds in Long Island Sound. No information is provided about the potential wetland impacts associated with the ELI alternative. The limited analysis allows for a conclusion that the ELI alternative appears to meet the project purpose and need with a reduced potential to impact the environment.

The Army Corps of Engineers similarly noted that :

The analysis, although incomplete, appears to suggest that the [ELI] alternative would be practicable, shorter in length (both onshore and offshore), cross fewer streams, avoid designated shellfish beds, affect fewer residences, and minimize trenching in the nearshore environment. Consequently, the ELI alternative . . . appears to meet the stated project purpose and need while discernably reducing potential adverse impact to the aquatic environment.

Letter of Christine Godfrey, Chief, Regulatory Division of the ACOE, dated June 17, 2002 to the FERC.

More importantly, even if one assumes that the need for natural gas advanced by Islander East both exists and is a legitimate purpose, there is nothing in this definition of project purpose that presupposes that only one particular pipeline route can satisfy that need. If there is, in fact, a need for 285,000 Dth/d of natural gas on Long Island, then it clearly does not matter, from the

standpoint of "need," *how* that quantity of natural gas gets there or the pipeline route taken to reach Long Island. Thus, the claim by Islander East that a certain amount of gas needs to be made available does not translate into a conclusion that only a pipeline through the Thimble Islands will address and meet that need.

Consequently, in the necessary balancing of water-dependent uses versus economic benefit that must be undertaken in evaluating this project, it is clear that the benefit will not be there at all, certainly from the perspective of New England. The importance of the water-dependent use, on the other hand, is clearly evident and the threat to this use is significant. Connecticut's stewardship of the Sound and the significant measures taken by it to preserve and improve the essential natural characteristics of this environmental resource will be undermined if this project is approved. Further, there is *no* reason why the benefit, if it exists, cannot be obtained by simply moving the proposed pipeline route out of the critical habitat area. To the contrary, each and every regulator which has reviewed this project has concluded that the alternative route proposed by the ELI project is superior. Thus, in the absence of any evidence, let alone credible evidence, that only the one designated route is feasible, and the conclusive evidence of at least one feasible and preferable alternative, the law plainly requires denial of this application.

### Conclusion

Ultimately, Islander East has used obsolete and questionable data to create a "need" for natural gas that does not exist. Even if there were a real need, it could be satisfied by any of a number of less damaging alternatives. Under state law, it is clear that the precious and heretofore untouched resources of the Thimble Islands cannot be destroyed to permit a profoundly damaging project that, if it truly needs to be built, can easily be relocated to less critical areas.

Very truly yours,



RICHARD BLUMENTHAL  
Attorney General



## Exhibit A



TO: Robert Snook, Esq.

FROM: Philip Sussler

RE: Assessment of "Need" for the Islander East proposed gas pipeline

DATE: March 20, 2003 (revised)

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### **Introduction:**

The Islander East project (the "Project") is a proposed natural gas pipeline running from Connecticut, across Long Island Sound, to Long Island, New York.<sup>1</sup> The project will interconnect with the existing C-system of the Algonquin pipeline ("AGT") at North Haven, CT, will enter Long Island Sound at Branford, CT, and will come ashore on Long Island at Wading River (near Brookhaven, N.Y.) and interconnect on Long Island with the gas distribution system of KeySpan Energy ("KeySpan"), the local gas distribution company (or "LDC") serving Long Island.

The Project also entails upgrades to the existing Algonquin pipeline system in Connecticut affecting approximately 13.7 miles of existing parallel pipelines and the installation of a new compressor station by AGT in Cheshire, CT. The Project proposes to lease these incremental facilities on the AGT system. Approximately 22.6 miles of the proposed new pipeline will be located offshore in Long Island Sound, 10.2 miles will be located on onshore in Connecticut and, 12 miles located onshore in Long Island. The Project is sponsored by a limited liability company formed by subsidiaries of Duke Energy, the owner of AGT, and KeySpan. The anticipated construction cost of the Project is \$149.6 MM and its originally anticipated in-service date was November 1, 2003. Commencement of construction has been delayed pending receipt of necessary regulatory and environmental permits.

The Project filed for a certificate of public convenience and necessity ("CEPCN") with the Federal Energy Regulatory Commission ("FERC") on June 15, 2001. FERC issued its Preliminary Determination ("PD") for the Project on December 21, 2001, in which it approved the economic and regulatory (non-environmental) aspects of the Project. *Islander East Pipeline Co. LLC*, 97 FERC ¶61,363 (2001). FERC reserved for later decision issuance of the certificate, pending its review of the environmental impacts of the Project, which it then decided, issuing the CEPCN to the Project, in its order issued on September 19, 2002, *Islander East Pipeline Co. LLC*, 100 FERC ¶61,276 (2002). Subsequent to these FERC approvals, the Project failed to receive its consistency approval under the Coastal Zone Management Act from the Connecticut Department of

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<sup>1</sup> The Project is proposed to be approximately 44.8 miles in length and consist of a 24-inch, pipe with 900 pounds per square inch maximum allowable operating pressure.

Environmental Protection (“DEP”). In addition, the Project’s approval from the Army Corps of Engineers is still pending.

This report assesses and critiques the “need” for the proposed pipeline.

### **Summary and Conclusions:**

Islander East premises the need for its project on precedent agreements indicating commitment for 260,000 Dth/day out of the total proposed incremental capacity of 285,000 Dth/day. The power plant developer counter-parties to these precedent agreements do not need the incremental capacity, either because (in the case of AES) they appear to have ceased project development or (in the case of ANP) have made alternate arrangements. The LDC counter-party is a partner in the proposed pipeline so it is not clear whether and to what extent its commitment to utilize the gas is binding. Islander East also premises the need for its project on a general assessment of the gas market on Long Island that substantially overstates the anticipated growth rate of gas usage on the island (by a factor of 4 or more) and inflates substantially the likely gas requirements of the power sector. In addition, the Islander East market study fails to analyze the ability of the substantial increases in gas pipeline delivery infrastructure planned and/or under construction for the New York City metropolitan area to fully displace any requirement for the relatively small incremental volumes which will be made available by the Islander East project.

### **Detailed Discussion:**

The Project’s sponsor, in its application for a CEPCN to FERC, justified the need for the Project, in part, by submitting “precedent agreements” for rights to transport volumes of gas. These agreements were with different divisions of KeySpan for delivery to its New York City area (referred to as “KEDNY”) and Long Island area (referred to as “KEDLI”) local gas distribution systems and with two developers of proposed power plants on Long Island, namely: (a) AES Endeavor, a division of AES Corporation (AES Calverton); and (b) Brookhaven Energy Limited Partnership, an affiliate of American National Power (ANP Brookhaven). The Project will serve primarily as a radial extension of the existing AGT system and will permit the transportation of gas supply from the existing AGT system to delivery points on Long Island. The Project itself adds no new gas supplies, rather it is a build out and extension of the existing gas transportation infrastructure.

The specific transportation volume commitments indicated in each of the precedent agreements entered into by Islander East are as follows:

Table I – Islander East Proposed Transportation Volumes <sup>2</sup>						
Proposed Customer:	Maximum Daily Quantity at Year Beginning					
	11/1/03	11/1/04	11/1/05	11/1/06	11/1/07	11/1/08
ANP Brookhaven	90,000	90,000	90,000	90,000	90,000	90,000
AES Endeavor	60,000	60,000	60,000	60,000	60,000	60,000
KEDLI maximum (after yearly election)	60,500	82,500	112,750	134,750	162,250	162,250
KEDLI minimum (after yearly election)	60,500	71,500	92,000	114,000	138,000	162,250
KEDNY maximum (after yearly election)	49,500	67,500	92,250	110,250	132,750	132,750
KEDNY minimum (after yearly election)	49,500	58,500	75,500	93,000	112,000	132,750
Total Maximum MDQ <sup>3</sup>	260,000	300,000	355,000	395,000	445,000	445,000
Total Minimum MDQ	260,000	280,000	317,500	357,000	400,000	445,000

The proposed transportation capacity of the pipeline will be initially 285,000 DTH/day. The remaining 25,000 DTH/day of available capacity (after accounting for the volumes designated in the precedent agreements) is proposed for interruptible and short-term services. The timing and scope of upgrades to the line to increase the capacity to accommodate the maximum volumes authorized under the precedent agreements in later years is “not certain” (IE application, p.22). Required upgrades would occur through the addition of incremental compression capacity and pipeline looping. *Id.* at 22.

The Project sponsors assert that these projected incremental transportation volumes will be demanded and can be met by the proposed Project for delivery into Long Island and that, implicitly, existing and other new gas infrastructure projects are insufficient to meet the same requirements.<sup>4</sup> As described in greater detail below, these assertions are problematic or incorrect and/or based on faulty assumptions.

Iroquois Pipeline also applied for a CEPCN with FERC to approve a pipeline project (the so-called ELI project) crossing Long Island Sound from Milford, CT, to Brookhaven, LI, with an anticipated delivery capacity of 175,000 DTH/day. This project, although executing precedent agreements with different counter-parties than Islander East, essentially paralleled the Islander East project and would have served the same ultimate market on Long Island. FERC issued a PD approving the non-environmental aspects of the ELI project by order, dated September 19, 2002, 100 FERC ¶61,275 (2002). Iroquois

<sup>2</sup> Application of Islander East Pipeline Company, LLC, FERC docket CP01-384-000 (June 15, 2001) at p. 21. (The Islander East FERC application is referred to hereafter as the “IE Application”).

<sup>3</sup> MDQ is the maximum daily quantity measured in dekatherms. A dekatherm is 10 therms. A therm has the heating content equivalent of approximately 100 cubic feet of natural gas.

<sup>4</sup> These assessments of the gas market on Long Island are contained in a report prepared by Merrimack Energy for Islander East and filed as Exhibit I-1 in the IE Application.

has reportedly subsequently withdrawn the project based on, among other factors, uncertainties relating to permitting and lack of adequate demand. Iroquois' withdrawal of the ELI project is, at a minimum, indication that incremental demand beyond that asserted to exist by Islander East is insufficient to support incremental pipeline capacity.

In the remainder of this report, we analyze the Islander East Pipeline Project's projected demand, by focussing on the asserted two groups of potential users of the facility – the power plant developers (AES and ANP) and the LDC (KEDLI and KEDNY).

## **1 Power Plant Developers.**

The two power plant project developers which signed precedent agreements to utilize the pipeline, either are currently not going forward with further project development (AES) or have negotiated alternative arrangements to acquire gas supplies (ANP). The volumes nominated under these precedent agreements comprise more than half of the capacity of the line; so that uncertainty about the commitments of these developers is a critical issue for the viability of the pipeline.

AES, the parent of the entity developing the AES Calverton project, is a global power plant developer and operator. Along with many other companies in the electric power generation business during the past year, AES has experienced extreme financial stresses entailing the selling of power plant assets, the surrender of assets to secured lenders and the halting of power plant development efforts. Reflecting this status, the AES Calverton project has not advanced in development.<sup>5</sup> While no official announcement has been issued canceling the project, it is anticipated that the project will not be pursued.

The ANP Brookhaven project, a proposed natural gas-fired 580 MW electric generating plant located in Brookhaven, Long Island, has undertaken gas supply arrangements which do not require it to utilize the Islander East pipeline, if the pipeline is not constructed. The ANP project was granted a certificate of environmental compatibility and public need by the New York State Board on Electric Generation Siting and the Environment ("NYSB") under New York's so-called Article X process, by orders dated April 8, 2002 (the "Recommended Decision") and August 14, 2002 (the "Final Order"), in Case No. 00-F-0566. The Final Order was later confirmed in an "Order Denying Petition for Rehearing and Granting Petition for Clarification" dated October 24, 2002. The Long Island Power Authority ("LIPA"), the franchised electric utility operating on Long Island, objected to the project and intervened actively against it during the course of the proceeding.

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may negotiate with KeySpan Energy if the Islander East Pipeline Company facility is not a viable option. The topic agreement describes the upgrades KeySpan Energy's distribution system would require if it were to supply gas to the [ANP] Project. If the upgrades are installed, no adverse impacts are expected to occur to the existing gas transmission and distribution systems from the operation of the Project. Recommended Decision at 52.

The ANP project is anticipated to begin construction in the first quarter of 2003, with construction anticipated to take approximately two years.

Both precedent agreements entered into by Islander East and AES and ANP have termination and cancellation dates, which may be exercised if the pipeline project fails to receive its required permits by certain dates. Specifically, AES can cancel the precedent agreement, if permits are not granted to the pipeline project by certain outside dates, all of which have now passed. ANP can similarly cancel its precedent agreement. In addition, ANP and AES each had a one-time option, which must have been exercised by June 1, 2002, to reduce their capacity commitments by up to 40,000 and 20,000 DTH/day, respectively. It is not known whether these cancellation and/or volume reduction options have been exercised. If such rights have been exercised in light of the development uncertainties and issues facing the power projects, this would eliminate a substantial portion of the anticipated usage of the proposed pipeline.

The Merrimack Study, utilized to justify the Islander East project, also analyzed power plant sector gas demands as a general matter. The Study sought to demonstrate a continuing general need for gas supplies to serve new power plant construction on Long Island, buttressing the specific volumes nominated in the executed precedent agreements. This analysis, however, incorrectly identifies anticipated developments in that sector and inflates the likely gas requirements relating to power plant development.

Both the proposed ANP and AES power projects together (comprising over 1000 MW in installed capacity) and the ANP project alone exceed the projected growth in summer electric peak load on Long Island of 313 MW for the period 2002-2005.<sup>6</sup> It is also the case, that new electric generating capacity, if constructed, will operate typically at substantially improved efficiencies when compared with older generation, with conversion efficiencies (converting a given amount of gas into electricity) nearly 40% better than existing generating facilities. Thus, if the ANP plant is constructed it can be anticipated to displace existing oil and gas-fired electric generation located on Long Island, producing more power utilizing substantially less gas than equivalent generation produced by existing facilities. The Merrimack Study also incorrectly assumed that

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needed electric generating capacity was a proxy for incremental gas requirements. In reality, incremental electric generation capacity is required in large part to serve peak electric loads only and does not run continuously. These electric loads are more likely to occur during summer periods when the LDC demand for gas is likely to be low – such that the electric power generation requirements are not additive, as the Merrimack Study incorrectly assumes, with that servicing the KeySpan gas distribution requirements.

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To summarize, with respect to the two power projects which had signed up for the Islander East pipeline, the AES plant is not advancing and likely will not be developed; and the ANP plant has alternative sources for its gas. More generally, the anticipated general need to add power plant capacity on Long Island is not likely to require the incremental transport volumes made available by the proposed pipeline.

## **2. Gas LDC Demands.**

In addition to the asserted demand for Islander East resulting from proposed power plant projects on Long Island, the Project also premised a major portion of the anticipated usage of its facilities to stem from the gas requirements of the KeySpan local gas distribution operations on Long Island through KEDLI (serving Nassau and Suffolk Counties) and through KEDNY (serving Queens and Brooklyn, New York).

To put the project's anticipated usage rates in perspective, the maximum volumes committed for by KeySpan under precedent agreement with Islander East constitute 4.5% of peak-day send-out of the KEDNY system, 9.5% of the KEDLI system and 6.4% of the combined systems.<sup>7</sup> It is simply not the case that Islander East's proposed transport volumes, equivalent to a relatively small portion of KeySpan's overall usage, can only be met by the Islander East facilities and cannot be satisfied from existing infrastructure or

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other proposed gas infrastructure expansions serving the New York City metropolitan area.

KeySpan acquires the majority of its gas supply through the so-called New York Facilities System, which supplies some 60% of the natural gas requirements of the metropolitan New York City area, including Long Island. KeySpan also relies on local gas injection facilities (primarily LPG and LNG) to meet its peak load requirements. It also is currently serviced by two pipelines connecting to Long Island, Iroquois and Transco. A substantial number of other new natural gas pipeline projects have been proposed and are under construction to provide service into the New York metropolitan area which would more than satisfy KeySpan's incremental needs proposed to be met by the Islander East Project. These projects include the MarketLink, Millenium and Eastchester gas pipeline projects.<sup>8</sup> A listing of these projects is attached as Table II at the end of this report.

Charles River Associates, in a recent report completed for NYISO and the New York State Energy Research and Development Authority ("NYSERDA") concluded as follows:

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In addition to the 465 MDT per day of expansions already being added, the Federal Energy Regulatory Commission (FERC) has provisionally approved projects that could provide a total of approximately 800 MDT per day, primarily to the downstate region.<sup>9</sup>

Islander East's maximum day delivery capacity would comprise only 22% of this incremental capacity (both under construction and proposed).

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<sup>8</sup> The Millenium project runs 442 miles from Lake Erie to Mount Vernon, New York and has capacity for delivering 700,000 DTH/day, with capacity to deliver up to 350,000 DTH/day at its Westchester terminus and available to serve the metropolitan New York City area. The EastChester project alone, extending the Iroquois pipeline from Northport Long Island into the Bronx, will serve an incremental 220,000-330,000 DTH/day on a long haul basis into the New York City area. See Table II below.

<sup>9</sup> CRA, *The Ability to Meet Future Gas Demands for Electricity Generation in New York State*, prepared by for NYISO and NYSERDA (July, 2002) at 1 (referred to herein as the "CRA Report"). The 456,000 DTH/day capacity does not include Islander East. *Id.* at \_\_, n.22. The cited 800,000 DTH/day in provisionally approved gas transportation capacity should be reduced to 515,000 DTH/day, exclusive of the Islander East capacity which was counted in arriving at the 800,000 DTH/day cited in the text. This lower value still comprises a very large expansion in pipeline deliverability to the New York down-state region.

In addition, Islander East premised the volumes committed to KEDNY and KEDLI on excessive projected rates of growth of gas demand on their systems. Islander East projected a 6% annual growth rate for gas throughput in its market study for the period from 2003 to 2010. It is highly unlikely that anything close to this growth rate will be reached.<sup>10</sup> This projection should be compared with a growth rate of 1.2% made by the federal Energy Information Agency for the Middle Atlantic region. Population, a key driver of gas consumption, is anticipated to grow very slowly on Long Island (at 0.5% annually). In addition, the growth in gas demand is sensitive to changes in the price of gas. High and volatile gas prices typically inhibit demand growth. Gas prices in recent periods have been highly volatile and, for extended periods, in excess of the equivalent price of fuel oil.

Finally, KeySpan is a 50% partner in the Islander East project. Given its role in ownership of the project, it is not clear the extent to which its obligations to market the gas from the project are binding (as they would be if the arrangement was negotiated with an independent third-party) and, therefore, reflective of actual demand in KeySpan's service territory.

### **3. Interactive Effects of Gas LDC and Power Plant Demand and Power Plant Displacement.**

As noted previously, gas demand from the power sector typically is greater in the summer because the electric system in the New York City metropolitan area experiences its peak usage during the summer driven by air conditioning loads. Gas LDC demand in the U.S. Northeast, by contrast, typically peaks in the winter (because of its heavy use for heating). In addition, new gas-fired electric generation is much more efficient in utilizing gas to generate electricity and, to the extent it displaces older gas-fired electric generation, may actually decrease gas used for electric generation.

Islander East's market demand analysis assumed that the separate demands for electric power and by the gas LDCs are additive, when, in fact, they exhibit substantial seasonal diversity. In addition, it does not appear that the market analysis considered appropriately the effects on gas use of the improved efficiency of new power plants. As a result, Islander East's projected need for the Project substantially overstates the incremental contribution to gas demand resulting from electric power needs.

CRA in its July, 2002 report to NYISO and NYSERDA described these phenomena as follows:

Gas fired, combined-cycle (CC) plants account for almost 90 percent of the new electric generating capacity proposed for New York. These CC units are substantially more efficient than existing gas-fired steam units. For each British thermal unit (Btu) of gas, a new CC unit can produce about 50 percent more

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<sup>10</sup> DRI\*WEFA, *Natural Gas Consumption Outlook for New York City Metropolitan Areas and Long Island* (2002).



electricity than a steam unit. Hence, the presence of these units will increase gas demands only if generation from existing units burning other fuels or imports from other regions are displaced; if generation from less efficient gas-fired units is displaced, gas demands will *decrease*, ceteris paribus. New units are most likely to displace non-gas-fired generation during winter periods when gas delivery capacity has been unavailable to generators and steam units have opted to burn residual oil. In the summer, when more gas has been used for generation historically, new gas-fired units are more likely to replace generation from less-efficient, existing gas-fired units.  
CERA Report at 2.

CRA, in the CRA Report, conducted a detailed modeling of gas demand and likely electric generation expansion scenarios for New York State and, separately for down-state, in order to forecast the adequacy of the gas infrastructure system to serve both non-electric gas demand and gas-fired electric generation. CERA concluded as follows:

With the addition of 465 MDT per day of pipeline capacity assumed to be in place by November, 2003 [which does not include the Islander East volumes], New York will have sufficient gas delivery capacity to supply the amounts of gas required to generate under all 2005 generation and post-2003 pipeline addition [anywhere from 0 to 800 MDT/day incremental additions] scenarios provided the existing ability to burn oil is retained.  
CERA Report at 5.

Table II – Incremental Pipeline Projects serving metropolitan NYC <sup>11</sup>				
Project	Length	Maximum Delivery Volume	Beginning - Terminus	FERC order approving project
MarketLink Phase I and II		115,000 DTH/day (Phase I to NY) 130,000 DTH/day (Phase II to PA and NJ)	Extension of the Transco Leidy Line from Leidy, PA to NYC	FERC approval
Hanover Compressor		135,000 DTH/day	Increased compression at AGT compressor station in Hanover, NJ	FERC approval
Leidy East		130,000 DTH/day	Looping and added compression on Transco's Leidy Line in PA and NJ	FERC approval
Millenium	442 miles	700,000 DTH/day; 350,000 DTH/day (deliverability into NYC area)	Lake Erie/Mount Vernon, New York	FERC approval: PD Dec., 2001; CEPCN, Sept., 2002
East Chester		230,000 DTH/day	Northport, LI to the Bronx, NY	FERC approval
Texas Eastern Incremental Market Expansion		100,000 DTH/day	Expansion in TETCO system for delivery to NJ Natural Gas Company	
Iroquois Brookfield		85,000 DTH/day	Delivery to marketing and power companies in NYC	
ConneXion Project		500,000 DTH/day	Expansion in storage and delivery to NYC on Tennessee Pipeline	
Blue Atlantic	750 miles, undersea	1,000,000 DTH/day	El Paso project running from Nova Scotia to NYC area	

<sup>11</sup> Source: New York State Planning Board, *2002 State Energy Plan and Final Environmental Impact Statement* (June, 2002), section 3.5.

Version 2.0  
Draft -- PRIVILEGED AND CONFIDENTIAL -- Draft  
MEMORANDUM

TO: Robert Snook, Esq.

FROM: Philip Sussler

RE: Assessment of "Need" for the Islander East proposed gas pipeline

DATE: March 20, 2003 (revised)

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**Introduction:**

The Islander East project (the "Project") is a proposed natural gas pipeline running from Connecticut, across Long Island Sound, to Long Island, New York.<sup>1</sup> The project will interconnect with the existing C-system of the Algonquin pipeline ("AGT") at North Haven, CT, will enter Long Island Sound at Branford, CT, and will come ashore on Long Island at Wading River (near Brookhaven, N.Y.) and interconnect on Long Island with the gas distribution system of KeySpan Energy ("KeySpan"), the local gas distribution company (or "LDC") serving Long Island.

The Project also entails upgrades to the existing Algonquin pipeline system in Connecticut affecting approximately 13.7 miles of existing parallel pipelines and the installation of a new compressor station by AGT in Cheshire, CT. The Project proposes to lease these incremental facilities on the AGT system. Approximately 22.6 miles of the proposed new pipeline will be located offshore in Long Island Sound, 10.2 miles will be located on onshore in Connecticut and, 12 miles located onshore in Long Island. The Project is sponsored by a limited liability company formed by subsidiaries of Duke Energy, the owner of AGT, and KeySpan. The anticipated construction cost of the Project is \$149.6 MM and its originally anticipated in-service date was November 1, 2003. Commencement of construction has been delayed pending receipt of necessary regulatory and environmental permits.

The Project filed for a certificate of public convenience and necessity ("CEPCN") with the Federal Energy Regulatory Commission ("FERC") on June 15, 2001. FERC issued its Preliminary Determination ("PD") for the Project on December 21, 2001, in which it approved the economic and regulatory (non-environmental) aspects of the Project. *Islander East Pipeline Co. LLC*, 97 FERC ¶61,363 (2001). FERC reserved for later decision issuance of the certificate, pending its review of the environmental impacts of the Project, which it then decided, issuing the CEPCN to the Project, in its order issued on September 19, 2002, *Islander East Pipeline Co. LLC*, 100 FERC ¶61,276 (2002). Subsequent to these FERC approvals, the Project failed to receive its consistency approval under the Coastal Zone Management Act from the Connecticut Department of

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<sup>1</sup> The Project is proposed to be approximately 44.8 miles in length and consist of a 24-inch, pipe with 900 pounds per square inch maximum allowable operating pressure.

Environmental Protection (“DEP”). In addition, the Project’s approval from the Army Corps of Engineers is still pending.

This report assesses and critiques the “need” for the proposed pipeline.

### **Summary and Conclusions:**

Islander East premises the need for its project on precedent agreements indicating commitment for 260,000 Dth/day out of the total proposed incremental capacity of 285,000 Dth/day. The power plant developer counter-parties to these precedent agreements do not need the incremental capacity, either because (in the case of AES) they appear to have ceased project development or (in the case of ANP) have made alternate arrangements. The LDC counter-party is a partner in the proposed pipeline so it is not clear whether and to what extent its commitment to utilize the gas is binding. Islander East also premises the need for its project on a general assessment of the gas market on Long Island that substantially overstates the anticipated growth rate of gas usage on the island (by a factor of 4 or more) and inflates substantially the likely gas requirements of the power sector. In addition, the Islander East market study fails to analyze the ability of the substantial increases in gas pipeline delivery infrastructure planned and/or under construction for the New York City metropolitan area to fully displace any requirement for the relatively small incremental volumes which will be made available by the Islander East project.

### **Detailed Discussion:**

The Project’s sponsor, in its application for a CEPCN to FERC, justified the need for the Project, in part, by submitting “precedent agreements” for rights to transport volumes of gas. These agreements were with different divisions of KeySpan for delivery to its New York City area (referred to as “KEDNY”) and Long Island area (referred to as “KEDLI”) local gas distribution systems and with two developers of proposed power plants on Long Island, namely: (a) AES Endeavor, a division of AES Corporation (AES Calverton); and (b) Brookhaven Energy Limited Partnership, an affiliate of American National Power (ANP Brookhaven). The Project will serve primarily as a radial extension of the existing AGT system and will permit the transportation of gas supply from the existing AGT system to delivery points on Long Island. The Project itself adds no new gas supplies, rather it is a build out and extension of the existing gas transportation infrastructure.

The specific transportation volume commitments indicated in each of the precedent agreements entered into by Islander East are as follows:

Table I – Islander East Proposed Transportation Volumes <sup>2</sup>						
Proposed Customer:	Maximum Daily Quantity at Year Beginning					
	11/1/03	11/1/04	11/1/05	11/1/06	11/1/07	11/1/08
ANP Brookhaven	90,000	90,000	90,000	90,000	90,000	90,000
AES Endeavor	60,000	60,000	60,000	60,000	60,000	60,000
KEDLI maximum (after yearly election)	60,500	82,500	112,750	134,750	162,250	162,250
KEDLI minimum (after yearly election)	60,500	71,500	92,000	114,000	138,000	162,250
KEDNY maximum (after yearly election)	49,500	67,500	92,250	110,250	132,750	132,750
KEDNY minimum (after yearly election)	49,500	58,500	75,500	93,000	112,000	132,750
Total Maximum MDQ <sup>3</sup>	260,000	300,000	355,000	395,000	445,000	445,000
Total Minimum MDQ	260,000	280,000	317,500	357,000	400,000	445,000

The proposed transportation capacity of the pipeline will be initially 285,000 DTH/day. The remaining 25,000 DTH/day of available capacity (after accounting for the volumes designated in the precedent agreements) is proposed for interruptible and short-term services. The timing and scope of upgrades to the line to increase the capacity to accommodate the maximum volumes authorized under the precedent agreements in later years is “not certain” (IE application, p.22). Required upgrades would occur through the addition of incremental compression capacity and pipeline looping. *Id.* at 22.

The Project sponsors assert that these projected incremental transportation volumes will be demanded and can be met by the proposed Project for delivery into Long Island and that, implicitly, existing and other new gas infrastructure projects are insufficient to meet the same requirements.<sup>4</sup> As described in greater detail below, these assertions are problematic or incorrect and/or based on faulty assumptions.

Iroquois Pipeline also applied for a CEPCN with FERC to approve a pipeline project (the so-called ELI project) crossing Long Island Sound from Milford, CT, to Brookhaven, LI, with an anticipated delivery capacity of 175,000 DTH/day. This project, although executing precedent agreements with different counter-parties than Islander East, essentially paralleled the Islander East project and would have served the same ultimate market on Long Island. FERC issued a PD approving the non-environmental aspects of the ELI project by order, dated September 19, 2002, 100 FERC ¶61,275 (2002). Iroquois

<sup>2</sup> Application of Islander East Pipeline Company, LLC, FERC docket CP01-384-000 (June 15, 2001) at p. 21. (The Islander East FERC application is referred to hereafter as the “IE Application”).

<sup>3</sup> MDQ is the maximum daily quantity measured in dekatherms. A dekatherm is 10 therms. A therm has the heating content equivalent of approximately 100 cubic feet of natural gas.

<sup>4</sup> These assessments of the gas market on Long Island are contained in a report prepared by Merrimack Energy for Islander East and filed as Exhibit I-1 in the IE Application.

has reportedly subsequently withdrawn the project based on, among other factors, uncertainties relating to permitting and lack of adequate demand. Iroquois' withdrawal of the ELI project is, at a minimum, indication that incremental demand beyond that asserted to exist by Islander East is insufficient to support incremental pipeline capacity.

In the remainder of this report, we analyze the Islander East Pipeline Project's projected demand, by focussing on the asserted two groups of potential users of the facility – the power plant developers (AES and ANP) and the LDC (KEDLI and KEDNY).

## **1 Power Plant Developers.**

The two power plant project developers which signed precedent agreements to utilize the pipeline, either are currently not going forward with further project development (AES) or have negotiated alternative arrangements to acquire gas supplies (ANP). The volumes nominated under these precedent agreements comprise more than half of the capacity of the line; so that uncertainty about the commitments of these developers is a critical issue for the viability of the pipeline.

AES, the parent of the entity developing the AES Calverton project, is a global power plant developer and operator. Along with many other companies in the electric power generation business during the past year, AES has experienced extreme financial stresses entailing the selling of power plant assets, the surrender of assets to secured lenders and the halting of power plant development efforts. Reflecting this status, the AES Calverton project has not advanced in development.<sup>5</sup> While no official announcement has been issued canceling the project, it is anticipated that the project will not be pursued.

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Substantial expansion of the New York pipeline infrastructure is already underway. With projects that have recently been completed or are expected to be completed by the end of 2003, a total of 465 thousand dekatherms (MDT) per day of new delivery capacity will be available into the downstate region. This additional capacity represents a 7 percent increase in delivery capacity to the State and a 16 percent increase into the downstate region, and exceeds forecasted growth in nongeneration gas demands through at least 2005.

In addition to the 465 MDT per day of expansions already being added, the Federal Energy Regulatory Commission (FERC) has provisionally approved projects that could provide a total of approximately 800 MDT per day, primarily to the downstate region.<sup>9</sup>

Islander East's maximum day delivery capacity would comprise only 22% of this incremental capacity (both under construction and proposed).

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<sup>8</sup> The Millenium project runs 442 miles from Lake Erie to Mount Vernon, New York and has capacity for delivering 700,000 DTH/day, with capacity to deliver up to 350,000 DTH/day at its Westchester terminus and available to serve the metropolitan New York City area. The EastChester project alone, extending the Iroquois pipeline from Northport Long Island into the Bronx, will serve an incremental 220,000-330,000 DTH/day on a long haul basis into the New York City area. See Table II below.

<sup>9</sup> CRA, *The Ability to Meet Future Gas Demands for Electricity Generation in New York State*, prepared by for NYISO and NYSERDA (July, 2002) at 1 (referred to herein as the "CRA Report"). The 456,000 DTH/day capacity does not include Islander East. *Id.* at \_\_, n.22. The cited 800,000 DTH/day in provisionally approved gas transportation capacity should be reduced to 515,000 DTH/day, exclusive of the Islander East capacity which was counted in arriving at the 800,000 DTH/day cited in the text. This lower value still comprises a very large expansion in pipeline deliverability to the New York down-state region.

In addition, Islander East premised the volumes committed to KEDNY and KEDLI on excessive projected rates of growth of gas demand on their systems. Islander East projected a 6% annual growth rate for gas throughput in its market study for the period from 2003 to 2010. It is highly unlikely that anything close to this growth rate will be reached.<sup>10</sup> This projection should be compared with a growth rate of 1.2% made by the federal Energy Information Agency for the Middle Atlantic region. Population, a key driver of gas consumption, is anticipated to grow very slowly on Long Island (at 0.5% annually). In addition, the growth in gas demand is sensitive to changes in the price of gas. High and volatile gas prices typically inhibit demand growth. Gas prices in recent periods have been highly volatile and, for extended periods, in excess of the equivalent price of fuel oil.

Finally, KeySpan is a 50% partner in the Islander East project. Given its role in ownership of the project, it is not clear the extent to which its obligations to market the gas from the project are binding (as they would be if the arrangement was negotiated with an independent third-party) and, therefore, reflective of actual demand in KeySpan's service territory.

### **3. Interactive Effects of Gas LDC and Power Plant Demand and Power Plant Displacement.**

As noted previously, gas demand from the power sector typically is greater in the summer because the electric system in the New York City metropolitan area experiences its peak usage during the summer driven by air conditioning loads. Gas LDC demand in the U.S. Northeast, by contrast, typically peaks in the winter (because of its heavy use for heating). In addition, new gas-fired electric generation is much more efficient in utilizing gas to generate electricity and, to the extent it displaces older gas-fired electric generation, may actually decrease gas used for electric generation.

Islander East's market demand analysis assumed that the separate demands for electric power and by the gas LDCs are additive, when, in fact, they exhibit substantial seasonal diversity. In addition, it does not appear that the market analysis considered appropriately the effects on gas use of the improved efficiency of new power plants. As a result, Islander East's projected need for the Project substantially overstates the incremental contribution to gas demand resulting from electric power needs.

CRA in its July, 2002 report to NYISO and NYSERDA described these phenomena as follows:

Gas fired, combined-cycle (CC) plants account for almost 90 percent of the new electric generating capacity proposed for New York. These CC units are substantially more efficient than existing gas-fired steam units. For each British thermal unit (Btu) of gas, a new CC unit can produce about 50 percent more

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<sup>10</sup> DRI\*WEFA, *Natural Gas Consumption Outlook for New York City Metropolitan Areas and Long Island* (2002).

electricity than a steam unit. Hence, the presence of these units will increase gas demands only if generation from existing units burning other fuels or imports from other regions are displaced; if generation from less efficient gas-fired units is displaced, gas demands will *decrease*, ceteris paribus. New units are most likely to displace non-gas-fired generation during winter periods when gas delivery capacity has been unavailable to generators and steam units have opted to burn residual oil. In the summer, when more gas has been used for generation historically, new gas-fired units are more likely to replace generation from less-efficient, existing gas-fired units.

CERA Report at 2.

CRA, in the CRA Report, conducted a detailed modeling of gas demand and likely electric generation expansion scenarios for New York State and, separately for down-state, in order to forecast the adequacy of the gas infrastructure system to serve both non-electric gas demand and gas-fired electric generation. CERA concluded as follows:

With the addition of 465 MDT per day of pipeline capacity assumed to be in place by November, 2003 [which does not include the Islander East volumes], New York will have sufficient gas delivery capacity to supply the amounts of gas required to generate under all 2005 generation and post-2003 pipeline addition [anywhere from 0 to 800 MDT/day incremental additions] scenarios provided the existing ability to burn oil is retained.

CERA Report at 5.

Table II – Incremental Pipeline Projects serving metropolitan NYC <sup>11</sup>				
Project	Length	Maximum Delivery Volume	Beginning - Terminus	FERC order approving project
MarketLink Phase I and II		115,000 DTH/day (Phase I to NY) 130,000 DTH/day (Phase II to PA and NJ)	Extension of the Transco Leidy Line from Leidy, PA to NYC	FERC approval
Hanover Compressor		135,000 DTH/day	Increased compression at AGT compressor station in Hanover, NJ	FERC approval
Leidy East		130,000 DTH/day	Looping and added compression on Transco's Leidy Line in PA and NJ	FERC approval
Millenium	442 miles	700,000 DTH/day; 350,000 DTH/day (deliverability into NYC area)	Lake Erie/Mount Vernon, New York	FERC approval: PD Dec., 2001; CEPCN, Sept., 2002
East Chester		230,000 DTH/day	Northport, LI to the Bronx, NY	FERC approval
Texas Eastern Incremental Market Expansion		100,000 DTH/day	Expansion in TETCO system for delivery to NJ Natural Gas Company	
Iroquois Brookfield		85,000 DTH/day	Delivery to marketing and power companies in NYC	
ConneXion Project		500,000 DTH/day	Expansion in storage and delivery to NYC on Tennessee Pipeline	
Blue Atlantic	750 miles, undersea	1,000,000 DTH/day	El Paso project running from Nova Scotia to NYC area	

<sup>11</sup> Source: New York State Planning Board, *2002 State Energy Plan and Final Environmental Impact Statement* (June, 2002), section 3.5.

## Exhibit B

## Greenspan Sees Higher Natural Gas Prices

By H. JOSEF HEBERT  
Associated Press Writer

WASHINGTON (AP) -- Federal Reserve chairman Alan Greenspan predicted tight supplies of natural gas and high prices for a prolonged period Tuesday, largely because - unlike oil - the U.S. market is unable to draw on world gas supplies easily.

"We are not apt to return to earlier periods of relative abundance and low prices anytime soon," Greenspan said in testimony at a congressional hearing. He noted that the markets are anticipating natural gas prices of more than \$6 a thousand cubic feet well into next year.

Market expectations "imply a 25 percent probability" that the peak price natural gas on the wholesale market exceed \$7.5 per thousand cubic feet by next January, in the middle of the winter heating season, Greenspan said.

Greenspan said that already the increase in gas prices - more than double what they were last year - "have put significant segments of the North American gas-using industry in a weakened competitive position" against industries overseas.

"Unless this competitive weakness is addressed, new investment in these technologies will flag," Greenspan said in his appearance before the House Energy and Commerce Committee.

### Advertisement



Greenspan did not specifically address whether these problems, affecting especially the chemical, fertilizer, steel and aluminum industries, might hinder economic recovery.

Earlier, the Energy Department said that extremely short supplies of natural gas in storage will result in high prices to continue through this year and into 2004. Gas stocks in storage were 38 percent below what they were last year and 28 percent lower than the five-year average.

"An abnormally hot summer, followed by a cold winter could push natural gas deliverability to the limit and cause record high prices," Guy Caruso, head of the government's Energy Information Administration, told a congressional hearing.


Greenspan said the supply and price problems stem from "a modest gap" between growing demand for the environmentally friendly fuel and supplies that are limited. "Rising demand for natural gas, especially as a clean-burning source of electric power, is pressing against a supply essentially restricted to North American production," said Greenspan.

"If the train wreck occurs and natural gas prices skyrocket and shortages occur, who will be at fault?" Rep. Billy Tauzin, R-La., the committee's chairman, had asked earlier. "We see a storm brewing on the horizon. We need to prepare for it."

But a panel of industry officials provided little insight on what might be done to increase supplies dramatically in the short term, or head off higher prices this summer and winter.

Richard Sharples, a vice president of Anadarko Petroleum Corp., said a chronic gap between supply and demand needs to be addressed by removing regulatory barriers to exploration and development, and providing industry with

That won't help consumers this year in Ohio where Donald Mason, head of the state Public Utilities Commission, predicted that the average residential heating bill next winter will be \$220 higher per household than it was last winter. He said he's trying to find a way to "prepare (people) for the sticker shock."

 "It's already impacted us," Greg Lebedev, president of the American Chemistry Council said in an interview. "And with the domino effect when you have an industry our size, it will by definition have a cascading effect on the entire economy."

Robert Liuzzi, president of CF Industries Inc., speaking on behalf of the fertilizer industry, said high fuel prices already have forced one-fifth of the industry production capacity to shut down. "This situation threatens to destroy an efficient U.S. industry and displace thousands of workers," he said in remarks prepared for the hearing.


The Bush administration also is worried.

Energy Secretary Spencer Abraham has asked the National Petroleum Council to provide a game plan before the end of this month on how to deal with "the looming challenges we face" because of the short-term natural gas supply crunch.

This spring, natural gas in storage dropped to 623 billion cubic feet, the lowest it has been since the government began keeping records in 1976. Stocks have increased somewhat, but remain 38 percent below last year, and 28 percent below the five-year average, according to the department's Energy Information Administration.

By next fall, the government would like to see about 3.5 trillion cubic feet of gas in storage to be ready for the winter heating season, or about three times the amount available now. The average natural-gas fueled home uses about 80 thousand cubic feet a year, according to the American Gas Association.

"The natural gas industry is at a critical crossroads," says Carl English, president of Consumers Energy in Jackson, Mich. He said while the federal government encourages increased use of natural gas to improve air quality and other reasons, it also makes it difficult to get it to meet the increased demand.

 A group of 29 Democratic senators recently wrote Abraham urging him to take steps to promote increased conservation to try to curtail gas demand this summer. Abraham agreed to push for conservation measures.

There will be enough gas to go around, but "we're trying to prepare customers for higher prices this winter regardless of the weather," says Peggy Laramie, a spokeswoman for the American Gas Association. The group represents 191 utilities that deliver natural gas to more than 53 million homes.

The spot price on Monday for natural gas was \$6.25 per 1,000 cubic feet at the Henry Hub transit center in Louisiana. The average price was about \$3 per 1,000 cubic feet last year, and \$2.46 per 1,000 cubic feet from 1996-2000, according to the Energy Department.

Despite the high prices, there is little sign that the amount of gas being developed will increase significantly this year with the government expecting an overall 2 percent decline in production compared with last year. The number of drilling rigs has increased about 22 percent from a year ago, but remains below the number in operation in 2001 when surging prices caught the industry's attention.

On the Net:

Energy Department forecast: <http://www.eia.doe.gov>

American Gas Association: <http://www.aga.org/>

Advertisement



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August 14, 2003

**VIA OVERNIGHT AIRBORNE EXPRESS**

Ms. Christine Godfrey  
Chief, Regulatory Division  
Department of the Army  
New England District, Corps of Engineers  
696 Virginia Road  
Concord, MA 01742-2751

Re: Supplemental Comments of the Attorney General of Connecticut on the Application of  
Islander East Pipeline Company for a permit under Section 404 of the Clean Water Act.

Dear Ms. Godfrey:

I submit this update to the Islander East Project "Need" Analysis which was attached to my comments that were entered into the administrative record on August 5<sup>th</sup> in opposition to the application of Islander East Pipeline Company, LLC ("Islander East") for a permit from the United States Army Corps of Engineers ("ACE") under Section 404 of the Clean Water Act ("CWA"), 33 U.S.C. § 1344.

As each and every regulator, state and federal, has noted, the Islander East project will cause severe and irreparable damage to the environment of Long Island Sound. The excavation of the pipeline trench will result in permanent scarring in the seafloor and long-term disruption in the benthic environment of the Thimble Islands, one of the last untouched natural ecosystems of the Sound. Furthermore, the same regulators have also noted that viable alternatives to this project exist with materially fewer adverse impacts.

At the public meeting held in Branford, Connecticut on August 5, 2003, Islander East Pipeline Company claimed that the purpose of its 50-mile long pipeline project is to provide 260,000 dekatherms per day (Dth/d) of natural gas to Long Island to meet expected demand. Further, the pipeline is supposedly intended to improve flexibility of supply by bringing natural gas from new offshore sources in eastern Canada to New England. It has, however, become increasingly clear that the expected demand on Long Island has not materialized and the anticipated new sources of supply in Canada may not become available.

Specifically, as noted in the attached report:



In its application to the Federal Energy Regulatory Commission ("FERC"), the Project emphasized as a major benefit justifying the Project that it afforded Long Island and Connecticut greater access to off-shore Eastern Canadian natural gas. *See, Application of Islander East Project*, FERC docket CP01-384-000 et al., (June 15, 2001) pp. 12, 15 and Exhibit I-1, Merrimack Energy, *Islander East Market Study (June, 2001)* pp. 3, 4. By implication, if the Project afforded access to natural gas sourcing from eastern Canada by way of backhauls on the Algonquin pipeline, as well as existing gas delivery arrangements from western Canada and the US Gulf Coast, the Project presumably would improve the flexibility of gas supply to its potential customers. Recent disappointing results in natural gas exploration and production activities in off-shore Eastern Canada, however, substantially undercut this important premise for the Project.

The decline in production from the Sable Island project has already had important ramifications. As the attached report shows, several major projects, such as the EnCana Deep Panuke project and the Blue Atlantic pipeline project, have been put on indefinite hold. If, as appears to be the case, the Sable Island region will not be providing any major quantities of additional natural gas to New England, the inevitable result is that Islander East will not be able to offer new flexibility of supply and, to the contrary, will merely create additional drain on the existing, limited supplies of natural gas from western Canada and the United States.

Similarly, while Islander East claimed that its project is needed to meet increasing demand on Long Island, this claim does not survive close scrutiny. As Mr. Sussler states in the attached report:

Since the preparation of the market assessment supporting the Project's FERC application, natural gas pricing has exhibited substantial upward movement on average (almost double) and dramatically increased volatility, even when compared with alternative fuels.<sup>1</sup> . . .

These increases in price level and price volatility can be anticipated to reduce materially annual growth rates for gas consumption assumed in the Project's market assessment,

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<sup>1</sup> See, e.g., Wall Street Journal, *Concern Rises About Inadequate US Natural Gas Supply* (May 23, 2003); Wall Street Journal, *Natural Gas Prices Are Likely to be Higher and Amid Tight Supplies* (April 30, 2003).

obviously developed based on lower and less volatile gas pricing prevalent at the time of the preparation of the assessment.<sup>2</sup>

Therefore, it is clear that Islander East has overestimated both supply and demand for its project. This conclusion is of great importance. As Colonel Thomas Koning pointed out at the August 5th meeting, a permit under Section 404 of the Clean Water Act cannot issue without a full analysis of, not only the environmental impacts, but also the economic impacts and public need for the proposed activity. As I have noted before, the decisional law is clear:

Under applicable Section 404 guidelines, a discharge of dredge or fill will not be permitted if, among other things, there is a "practicable alternative" to the proposed discharge that would have a less adverse impact on the aquatic ecosystem. 33 U.S.C. § 1344(b)(1); 40 C.F.R. § 230.10(a). An alternative is considered practicable if "it is available and capable of being done after taking into consideration cost, existing technology and **logistics in light of overall project purpose.**" 40 C.F.R. § 230.10(a)(2).

*Fund for Animals, Inc. v. Rice*, 85 F.3d 535, 542-43 (11<sup>th</sup> Cir. 1996) (Emphasis added.)

As noted above, the market need identified by Islander East is insupportable. The market analysis data underlying Islander East's statement of natural gas demand on Long Island predate the events of September 11, 2001 and the ongoing economic slowdown. As Mr. Sussler has noted, Islander East's claim of market need does not take into account recent natural gas price increases and natural gas price volatility. Further, to date none of the relevant regulators have focused on the fact that the Sable Island gas may not be there at all.

While questions about the extent of available Canadian supplies may still be open, it is completely obvious that the Islander East pipeline proposal poses a clear and substantial threat to the ecosystem of the Sound. Every relevant regulator agrees that the harms from this major construction project are substantial. The alleged public need for this project does not exist and

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<sup>2</sup> The federal Energy Information Administration's ("EIA's") projection of future gas prices is up and projection of national gas consumption growth is down significantly from prior forecasts. See, Railroad Commission of Texas, *Natural Gas Trends* (July 14, 2003) ("The average wellhead price of natural gas is projected to be \$4.73, \$4.65, \$4.76, and \$3.96 per Mcf for the 3rd and 4th quarters of 2003 and 1st and 2nd quarters of 2004, respectively, according to the Energy Information Administration's (EIA) July 2003 "Short-Term Energy Outlook." The price of natural gas averaged \$2.96 for 2002, and is projected to average \$4.97 for 2003, and \$4.34 for 2004. According to the EIA, U.S. natural gas demand is expected to decrease by 0.1 percent from 2002 to 2003 to 22.39 Tcf, and increase by 1.0 percent from 2003 to 2004 to 22.62 Tcf."). Prior EIA forecasts reflecting lower forecasted prices had estimated national annual growth rates of 3.4% during the period 2000-2002 and 2.3%. EIA, *U.S. Natural Gas Markets: Recent Trends and Prospects for the Future* (May, 2001) pp. xii, xiii. The Project's own market assessment did not address the potential impacts on gas consumption growth resulting from variations in price.



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even if there were a real need for this project, it could be satisfied by any of a number of less damaging alternatives. Under Section 404 of the Clean Water Act, the precious and heretofore untouched resources of the Thimble Islands cannot be destroyed to permit a profoundly devastating project without legitimate purpose. If a need was ever established, a pipeline could easily be located elsewhere.

Very truly yours,

A handwritten signature in black ink, appearing to read "Richard Blumenthal", written over the typed name.

RICHARD BLUMENTHAL

Attorney General

Attachment

cc: Charles Evans

Gene Muhlherr

**Office of Attorney General  
State of Connecticut  
Islander East Project "Need" Analysis Update  
August 13, 2003**

**1. Introduction and Summary:**

This memorandum provides an update of a previous report analyzing the "need" justification for the Islander East natural gas pipeline project (the "Project"), prepared in March, 2003 (the "Initial Report").

The memorandum focuses on two developments of material importance to the "need" justification for the Project, namely:

- (a) changes in the pace and magnitude of development of Eastern Canadian off-shore natural gas resources; and
- (b) changes in projections of the price of natural gas.

As described below, both these developments are adverse to the viability of the Project and make the Project's justification of need more problematic than as described in the Initial Report.

**2. Eastern Canadian Off-Shore Natural Gas Resources.**

In its application to the Federal Energy Regulatory Commission ("FERC"), the Project emphasized as a major benefit justifying the Project that it afforded Long Island and Connecticut greater access to off-shore Eastern Canadian natural gas. *See, Application of Islander East Project*, FERC docket CP01-384-000 *et al.*, (June 15, 2001) pp. 12, 15 and Exhibit I-1, Merrimack Energy, *Islander East Market Study (June, 2001)* (sometimes referred to below as the "Merrimack Study") pp. 3, 4. By implication, if the Project afforded access to natural gas sourcing from eastern Canada by way of backhauls on the Algonquin pipeline, as well as existing gas delivery arrangements from western Canada and the US Gulf Coast, the Project presumably would improve the flexibility of gas supply to its potential customers. Recent disappointing results in natural gas exploration and production activities in off-shore Eastern Canada, however, substantially undercut this important premise for the Project.

Offshore Canadian natural gas production began at the end of 1999, with the commencement of production at the Sable Offshore Energy ("SOE") Project, which supplies the newly constructed Maritimes and Northeast Pipeline ("MNP"). MNP connects through eastern Canada across Maine to the northern terminus of the existing Tennessee Gas Pipeline in northeastern Massachusetts. Production in offshore Canada occurs under very difficult conditions, requiring a relatively large infrastructure investment in both deep-sea exploration wells and pipeline gathering and ocean-to-shore

delivery systems. The National Energy Board of Canada (“NEB”) estimates that stand-alone project viability requires at least 1.5 – 6 Tcf<sup>1</sup> of reserves to justify this investment, with a development time-frame of approximately 6 years.<sup>2</sup> Individual well development is estimated to cost in excess of \$50 million.<sup>3</sup> These thresholds for development viability are substantially greater than for equivalent onshore development in other natural gas basins on the continent and can be anticipated to discourage development of the offshore Eastern Canadian natural gas prospects.

SOE began to experience a decline in production in 2002, requiring an acceleration of development of nearby fields in order to maintain production levels.<sup>4</sup> In addition, the one additional potential provider of gas supplies over the next five years, EnCana’s Deep Panuke project, was put on hold indefinitely in February of this year.<sup>5</sup> EnCana reported an estimated three and one half years of potential production available from the find, which very likely does not justify the incremental investment required to bring the field into production.<sup>6</sup>

Various parallel developments echo the current view of poor prospects for offshore Eastern Canada gas production. These include: (a) deferral of any expansion in the MNP. In April, 2003, MNP asked that its filing at FERC for expansion of its facilities’ throughput capacity to New England by 400,000 Mcf/Day be put on hold.<sup>7</sup> FERC continues to process the application, but awaits a status report from the MNP sponsors by December, 2003.<sup>8</sup> The EnCana gas production would have utilized the expanded capacity on the MNP line; with its cancellation the prospect for expansion of the MNP is substantially reduced; and (b) El Paso Corporation announced the postponement of its

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<sup>1</sup> Tcf means trillion cubic feet.

<sup>2</sup> NEB, *The Maritimes Natural Gas Market: An Overview and Assessment* (June, 2003) (the “NEB Study”), p. 12.

<sup>3</sup> Alexander’s Oil and Gas Connections, *Nova Scotia’s Offshore Oil Position Looks Foggy*, (June 3, 2003).

<sup>4</sup> NEB Study at 11. Others have reported that reserves available to the SOE Project, originally made in 1979, now are estimated at less than one third of the original estimates. Alexander’s Gas and Oil Connections, *Nova Scotia’s Offshore Oil Position Looks Foggy* (June 3, 2003).

<sup>5</sup> EnCana Press Release (Feb. 14, 2003).

<sup>6</sup> *Id.*

<sup>7</sup> The NEB Study reports the incremental capacity applied for by MPN as 400,000 Mcf/Day. NEB Study at 10. FERC reports it as 385,000 Dth/Day. 104 FERC ¶ 61,143 at para. 1 (July 28, 2003). This constitutes nearly a doubling of MNP’s current daily throughput capacity from the Maritime Canadian provinces. “Mcf” means thousand cubic feet.

<sup>8</sup> *Maritimes and Northeast Pipeline LLC*, 104 FERC ¶61,143 (July 28, 2003).

proposed Blue Atlantic pipeline project, entailing the construction of an offshore pipeline from the Eastern Canadian offshore production facilities to the New York City area.<sup>9</sup>

Absent additional supplies from offshore Eastern Canada, the presumed expansion in flexibility of the gas delivery system attendant on the Islander East project is substantially reduced. In these circumstances, Islander East, rather than facilitating bi-directional supplies and increased flexibility, instead may primarily wind up competing for scarce north-bound natural gas pipeline delivery capacity into New England from the existing Algonquin and Tennessee natural gas pipelines serving New England from the south.

### 3. Natural Gas Pricing.

In its filing at FERC for a certificate of public convenience and necessity ("CPCN"), the Project relied on a market assessment which projected high rates of growth in annual natural gas sales to customers in Keyspan's local distribution gas company franchise on Long Island and to electric generators located on the Island. Merrimack Energy, *Islander East Market Study* (June, 2001).<sup>10</sup> As noted in the Initial Report, these anticipated high rates of growth in gas consumption are highly problematic. Moreover, the Project's market assessment appeared not to have undertaken any analysis of the responsiveness of consumption growth to the changes in the price level and price volatility of natural gas.

Since the preparation of the market assessment supporting the Project's FERC application, natural gas pricing has exhibited substantial upward movement on average (almost double) and dramatically increased volatility, even when compared with alternative fuels.<sup>11</sup> A chart is attached showing changes in monthly average prices of natural gas at the wellhead as reported by the US Energy Information Administration ("EIA") which demonstrates this development.

These increases in price level and price volatility can be anticipated to reduce materially annual growth rates for gas consumption assumed in the Project's market assessment, obviously developed based on lower and less volatile gas pricing prevalent at the time of the preparation of the assessment.<sup>12</sup> Even though the price elasticity of residential

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<sup>9</sup> Alexander's Gas and Oil Connections, *Nova Scotia's Offshore Oil Position Looks Foggy* (June 3, 2003). Note that in the Initial Report the Blue Atlantic project was listed as one of many other gas delivery facilities under development or in construction to serve the New York City area. Removing the Blue Atlantic project from that analysis still leaves a number of projects with sizeable incremental new capacity under development or construction to serve the metropolitan New York City area.

<sup>10</sup> The Report was filed as Exhibit I-1 to Islander East's application for a CPCN with FERC.

<sup>11</sup> See, e.g., Wall Street Journal, *Concern Rises About Inadequate US Natural Gas Supply* (May 23, 2003); Wall Street Journal, *Natural Gas Prices Are Likely to be Higher and Amid Tight Supplies* (April 30, 2003).

<sup>12</sup> The EIA's projection of future gas prices is up and projection of national gas consumption growth is down significantly from prior forecasts. See, Railroad Commission of Texas, *Natural Gas Trends* (July 14, 2003) ("The average wellhead price of natural gas is projected to be \$4.73, \$4.65, \$4.76, and \$3.96 per Mcf for the 3rd and 4th quarters of 2003 and 1st and 2nd quarters of 2004, respectively, according to the Energy Information Administration's (EIA) July 2003 "Short-Term Energy Outlook." The price of natural gas

demand for natural gas may be relatively low, the severe price swings in natural gas can be presumed to have a significant effect on overall annual incremental growth rates and important adverse impacts on more price elastic commercial and industrial use of natural gas. EIA, presumably in part reflecting these changes in pricing behavior, has dramatically decreased their forecasts of annual consumption growth in natural gas. In its 2001 annual report, EIA projected national annual growth at 3.4% during 2000-2002 and 2.3% thereafter.<sup>13</sup> EIA's July 2003 "Short-Term Energy Outlook" now projects natural gas demand to decrease by 0.1% from 2002 to 2003 and to increase by 1% from 2003 to 2004.

Most notably, Federal Reserve Board Chairman Alan Greenspan recently, in his testimony before the US House Energy and Commerce Committee, underlined the tightening of the supply-demand balance for natural gas, the longer term fundamental upward movement in price and the related prospect for reduced consumption in response to price increases.<sup>14</sup> Increased price volatility also discourages investment in supply which could, at least in part, counter-balance these trends, as gas production companies are less likely to invest if price increases are highly variable.<sup>15</sup>

These trends in natural gas pricing further support the conclusion of the Initial Report that incremental gas consumption requirements on Long Island were substantially overstated in the Project's market assessment. Correspondingly, the incremental need proposed to be addressed by the Islander East Project is significantly less than that set forth in the Project's need justification.

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averaged \$2.96 for 2002, and is projected to average \$4.97 for 2003, and \$4.34 for 2004. According to the EIA, U.S. natural gas demand is expected to decrease by 0.1 percent from 2002 to 2003 to 22.39 Tcf, and increase by 1.0 percent from 2003 to 2004 to 22.62 Tcf." The Project's own market assessment had estimated an overall (including both electric and gas distribution demand) annual increase in Long Island gas consumption of 2.5%. Merrimack Study, p. 54. The study did not address the potential impacts on gas consumption growth resulting from variations in price.

<sup>13</sup> EIA, *U.S. Natural Gas Markets: Recent Trends and Prospects for the Future* (May, 2001) pp. xii, xiii.

<sup>14</sup> See Wall Street Journal, *Verbatim Text of Greenspan's Testimony on Natural Gas* (June 10, 2003) (Chairman Greenspan stated in relevant part: "Yesterday the price of gas for delivery in July closed at \$6.31 per million Btu. That contract sold for as low as \$2.55 in July 2000 and for \$3.65 a year ago. Futures markets project further price increases through the summer cooling season to the peak of the heating season next January. Indeed, market expectations reflected in option prices imply a 25 percent probability that the peak price will exceed \$7.50 per million Btu. Today's tight natural gas markets have been a long time in coming, and futures prices suggest that we are not apt to return to earlier periods of relative abundance and low prices anytime soon.

\*

In summary, the long-term equilibrium price for natural gas in the United States has risen persistently during the past six years from approximately \$2 per million Btu to more than \$4.50. The perceived tightening of long-term demand-supply balances is beginning to price some industrial demand out of the market. It is not clear whether these losses are temporary, pending a fall in price, or permanent.").

<sup>15</sup> See, e.g., EIA, *Natural Gas Markets: Recent Trends and Prospects for the Future* (May 2001), p. xi.

EIA Reported Monthly Average US Natural Gas Wellhead Price

